CBDT replaces guidelines for selection and referral of transfer pricing cases for assessment

Background
The Central Board of Direct Taxes (CBDT) issued a new Instruction no. 3/2016 replacing the existing Instructions1 regarding the ‘Guidelines for Implementation of Transfer Pricing Provisions’. Vide this Instruction, the CBDT has reiterated and prescribed an additional mandatory criteria to select cases for specialised Transfer Pricing (TP) scrutiny, clarified the role of Assessing Officers (AOs) and Transfer Pricing Officers (TPOs) and provided guidance for maintenance of the database.

Reference to the TPO
The CBDT has decided that the AO shall henceforth make a mandatory reference to the TPO only under the following circumstances as laid down in the aforesaid Instruction:

- All cases selected for scrutiny on the basis of TP risk parameters either under the:
  - Computer assisted scrutiny selection system; or
  - Compulsory manual selection system in accordance with the CBDT’s annual Instructions2

- Cases selected for scrutiny on non-TP risk parameters shall be referred to TPOs only in the following circumstances:
  - Where the taxpayer has either not filed the Accountant’s Report under Section 92E of the Income-tax Act, 1961 (the Act) or has not disclosed an international transaction or Specified Domestic Transactions (SDTs) or both in the Accountant’s Report;
  - Where there has been a TP adjustment of INR10 crore or more in an earlier assessment year and such an adjustment has been upheld by the judicial authorities or is pending in appeal; and
  - Where search and seizure or survey operations have been carried out and findings regarding TP issues in respect of international transactions or SDTs or both have been recorded by the Investigation Wing or the AO.

- Cases involving a TP adjustment in an earlier assessment year that has been fully or partially set-aside by the Income-tax Appellate Tribunal, High Court or Supreme Court on the issue of the said adjustment.

- The AO must, as a jurisdictional requirement, record the satisfaction that there is an income or potential of an income arising and/or being effected from an international transaction or SDT, where the taxpayer has either not filed

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1 Instruction No. 15/2015 and Instruction No.3/2003
2 Instruction No. 6/2014 for selection in Financial Year (FY) 2014-15 and Instruction No. 8/2015 for selection in FY 2015-16
Role of the TPO

- The role of the TPO is limited to determine the ALP in respect of international transactions or SDTs referred to it by the AO.

- If any other international transactions come to the notice of the TPO during the course of the proceedings before him/her, then he/she is empowered to determine the ALP of such other international transactions also by virtue of Section 92CA(2A) and (2B) of the Act.

- The TPO must take into consideration all the relevant facts and data available, and shall determine the ALP and pass a speaking order after seeking the necessary approvals.

- The TPOs, being the Additional/Joint Commissioner of Income Tax shall be assigned not more than 50 cases depending on the importance and complexity involved.

- In addition to the above, the TPO shall be responsible for conducting the compliance audit of Advance Pricing Agreements (APAs) and perform a scrutiny for the cases referred to it by the AO with respect to taxpayers opting for the safe harbour provisions.

Role of the AO after determination of the ALP

- The AO has to compute the total income of the assessee in conformity with the ALP determined by the TPO.

Maintenance of database

- The Commissioner of Income Tax (TP) shall ensure the expeditious resolution of cases referred by the AO to the TPO in their respective jurisdictions and accurate records of the same will be maintained in a specified format. It is endeavoured by the CBDT to use this database for determination of the ALP in identical/substantially identical cases.

Applicability

This Instruction is applicable with immediate effect. Further, the references made to TPOs after the issuance of Instruction no. 15/2015, which are not in conformity with this Instruction, may be withdrawn by the concerned Principal Commissioner of Income Tax or Commissioner of Income Tax.

Our comments

This Instruction is another step taken by the CBDT in moving towards a non-adversarial tax regime, wherein compliant taxpayers can expect a supportive interface with the tax department. Recognising that TP is a specialised subject and needs to be examined by an expert, the CBDT has made it mandatory that TP issues shall be examined only by the TPO.

This Instruction provides clarity on the issues such as jurisdictions of the AO/TPO, powers vested with the AO, criteria for selection of cases for TP scrutiny, etc. This removes one significant area of controversy between the tax department and taxpayers in India.

The shift from ‘monetary threshold’ based to risk-based parameters for selection of cases for TP scrutiny coupled with the restriction placed on the AO’s power to make manual references may result in fewer cases being subject to a rigorous scrutiny by the TPO.

Failure to disclose any international transaction or SDT or non-filing of the Accountant’s Report could subject the taxpayer’s case being referred to the TPO besides other penal consequences. Accordingly, it is imperative that appropriate disclosures are made in the annual tax filings by the taxpayers.